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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN 3038-AF06

Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is amending the margin requirements for uncleared swaps ("Final Rule") for swap dealers ("SD") and major swap participants ("MSP") for which there is not a prudential regulator ("CFTC Margin Rule"). The Final Rule amends the CFTC Margin Rule to permit the application of a minimum transfer amount ("MTA") of up to $50,000 for each separately managed account ("SMA") of a legal entity that is a counterparty to an SD or MSP in an uncleared swap transaction and to permit the application of separate MTAs for initial margin ("IM") and variation margin ("VM").

DATES: This Final Rule is effective **[INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

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SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory and Regulatory Background

In January 2016, the Commission adopted Regulations 23.150 through 23.161, namely the CFTC Margin Rule,[1] to implement section 4s(e) of the Commodity Exchange Act ("CEA"),[2] which requires SDs and MSPs for which there is not a prudential regulator[3] ("covered swap entity" or "CSE") to meet minimum IM and VM requirements adopted by the Commission by rule or regulation.

Regulations 23.152 and 23.153 require CSEs to collect or post, each business day, VM[4] for uncleared swap transactions with each counterparty that is an SD, MSP, or financial end user[5], and IM[6] for uncleared swap transactions for each counterparty that is an SD, MSP, or a financial end user that has material swaps exposure.[7] IM posted or collected by a CSE must be held by one or more custodians that are not affiliated with the

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[1] *See generally* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016). The CFTC Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission's regulations. 17 CFR 23.150 - 23.159, 23.161. In May 2016, the Commission amended the CFTC Margin Rule to add Regulation 23.160, 17 CFR 23.160, providing rules on its cross-border application. *See generally* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016). Commission regulations are found at 17 CFR Part 1 *et seq.* (2017), and may be accessed through the Commission's web site, *https://www.cftc.gov*.

[2] 7 U.S.C. 6s(e) (capital and margin requirements).

[3] CEA section 1a(39), 7 U.S.C. 1a(39) (defining the term ''prudential regulator'' to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency). The definition of prudential regulator specifies the entities for which these agencies act as prudential regulators.

[4] VM (or variation margin), as defined in Regulation 23.151, is the collateral provided by a party to its counterparty to meet the performance of its obligation under one or more uncleared swaps between the parties as a result of a change in the value of such obligations since the trade was executed or the last time such collateral was provided. 17 CFR 23.151.

[5] *See* definition of "financial end user" in Regulation 23.151. In general, the definition covers entities involved in regulated financial activity, including banks, brokers, intermediaries, advisers, asset managers, collective investment vehicles, and insurers. 17 CFR 23.151.

[6] IM (or initial margin) is the collateral (calculated as provided by § 23.154 of the Commission's regulations) that is collected or posted in connection with one or more uncleared swaps pursuant to §23.152. IM is intended to secure potential future exposure following default of a counterparty (*i.e.*, adverse changes in the value of an uncleared swap that may arise during the period of time when it is being closed out). *See* CFTC Margin Rule, 81 FR at 683.

[7] 17 CFR 23.152; 17 CFR 23.153.

CSE or the counterparty.[8] VM posted or collected by a CSE is not required to be maintained with a custodian.[9]

To alleviate the operational burdens associated with making de minimis margin transfers without resulting in an unacceptable level of uncollateralized credit risk, Regulations 23.152(b)(3) and 23.153(c) provide that a CSE is not required to collect or post IM or VM with a counterparty until the combined amount of such IM and VM, as computed under Regulations 23.154 and 23.155 respectively, exceeds an MTA of $500,000.[10] The term MTA (or minimum transfer amount) is further defined in Regulation 23.151 as a combined amount of IM and VM, not exceeding $500,000, under which no exchange of IM or VM is required.[11] Once the MTA is exceeded, the SD or MSP must collect or post the full amount of both IM and VM required to be exchanged with the counterparty.[12]

During the implementation of the CFTC Margin Rule, market participants identified certain operational and compliance burdens associated with the application of the MTA. To mitigate these burdens, the Division of Swap Dealer and Intermediary Oversight ("DSIO") staff issued two no-action letters.[13]

B. DSIO No-Action Letter No. 17-12 Addressing the Application of MTA to SMAs

In February 2017, DSIO staff issued a no-action letter in response to a request for relief from the Securities Industry and Financial Markets Association's Asset Management Group ("SIFMA AMG").[14] Staff stated that based on SIFMA AMG's

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[8] *See* 17 CFR 23.157(a).
[9] Regulation 23.157 does not require VM to be maintained in a custodial account. 17 CFR 23.157.
[10] 17 CFR 23.152(b)(3); 17 CFR 23.153(c); 81 FR at 653.
[11] 17 CFR 23.151 (defining the term "minimum transfer amount").
[12] *See* 17 CFR 23.152(b)(3); 17 CFR 23.153(c).
[13] Pursuant to a Commission plan of reorganization, DSIO was renamed Market Participants Division ("MPD") effective November 8, 2020.
[14] CFTC Letter No. 17-12, Regulations 23.152(b)(3) and 23.153(c): No-Action Position for Minimum Transfer Amount with respect to Separately Managed Accounts (Feb. 13, 2017) ("Letter 17-12"), *https://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-12.pdf*.

representations, it would not recommend enforcement action against an SD that does not comply with the MTA requirements of Regulations 23.152(b)(3) or 23.153(c) with respect to the swaps of a legal entity that is the owner of multiple SMAs, provided that, among other conditions, the SD applies an MTA no greater than $50,000 to each SMA.

SIFMA AMG sought no-action relief on behalf of members – asset management firms whose clients include large institutional investors, such as pension plans and endowments, that hire asset managers to exercise investment discretion over portions of the clients' assets for management in SMAs – that enter into uncleared swaps with SDs that are registered with the Commission and are subject to the CFTC Margin Rule.[15] SIFMA AMG requested relief that would permit SDs entering into swaps with SMAs to treat each SMA separately for the purposes of applying the MTA.

SIFMA AMG argued that the application of the MTA at the SMA owner or legal entity level presented significant practical challenges for SMAs that trade uncleared swaps with a single SD. SIFMA AMG stated that each SMA is governed by an investment management agreement that grants asset managers authority over a portion of their client's assets. An SD may face the same legal entity as a counterparty through multiple SMAs administered by different asset managers. Each SMA that trades derivatives typically has its own payment netting set corresponding to each International Swaps and Derivatives Association ("ISDA") master agreement and credit support annex ("CSA") used by an asset manager.[16] Because the SMAs exist independently from each other, with their assets held, transferred, and returned separately at the account level, SIFMA AMG asserted that it is impractical for asset managers to collectively calculate

[15] *Id*.

[16] The ISDA master agreement is a standard contract published by ISDA commonly used in over-the-counter derivatives transactions that governs the rights and obligations of parties to a derivatives transaction. A CSA sets forth the terms of the collateral arrangement for the derivatives transaction.

the MTA across the SMAs of a single owner and to move collateral, in the aggregate, across the accounts.

C. DSIO No-Action Letter No. 19-25 Concerning the Application of Separate MTAs for IM and VM

In December 2019, DSIO staff issued an additional no-action letter concerning the application of the MTA in response to a request for relief from ISDA on behalf of its member SDs.[17] DSIO stated that based on ISDA's representations, it would not recommend enforcement action against an SD or MSP that does not combine IM and VM amounts for the purposes of Regulations 23.152(b)(3) and 23.153(c). More specifically, the no-action position covers SDs or MSPs that apply separate MTAs for IM and VM obligations on uncleared swap transactions with each swap counterparty, provided that the combined MTA for IM and VM with respect to that counterparty does not exceed $500,000.

In its request for no-action relief, ISDA stated that separate MTAs for IM and VM better reflect the operational requirements and the legal structure of the Commission's regulations, noting that the CFTC Margin Rule requires IM to be segregated with an unaffiliated third party, while not imposing similar segregation requirements with respect to VM. ISDA asserted that, as a result, distinct workflows have been established for the settlement of IM through custodians and tri-party agents that are completely separate from the settlement process for VM.

D. Market Participant Feedback and Proposal

Swap market participants, including a subcommittee established by the CFTC's Global Markets Advisory Committee ("GMAC Subcommittee"), expressed support for the adoption of regulations consistent with the no-action letters, noting that Letter 19-25,

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[17] CFTC Letter No. 19-25, Regulations 23.151, 23.152, and 23.153 – Staff Time-Limited No-Action Position Regarding Application of Minimum Transfer Amount under the Uncleared Margin Rules (Dec. 6, 2019) ("Letter 19-25"), *https://www.cftc.gov/csl/19-25/download*.

in particular, is time-limited and, more generally, the codification of no-action positions can be beneficial in that it can provide certainty to market participants with respect to the application of the Commission's regulations.[18]

Consistent with this feedback, the Commission has expressed the view that adopting regulations in accordance with the terms of no-action letters, where feasible, can facilitate efforts by market participants to take the operation of the Commission's regulations into account in planning their uncleared swap activities. Accordingly, based on its experience implementing the CFTC Margin Rule and the administration of Letters 17-12 and 19-25, the Commission decided to issue a notice of proposed rulemaking ("Proposal") to amend the CFTC Margin Rule consistent with the staff positions set forth in those no-action letters, and to request comments on the Proposal.[19]

II. Final Rule

The Commission received six comment letters, all of which expressed support for the Proposal.[20] Commenters generally noted that the proposed amendments represent practical solutions that ease the operational burden of compliance with the CFTC Margin Rule without materially increasing systemic risk. Two commenters also noted that while consistent approaches to derivatives regulation are desirable, the Commission should adopt the proposed amendments even if the prudential regulators do not adopt similar

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[18] *See Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps*, Report to the CFTC's Global Markets Advisory Committee by the Subcommittee on Margin Requirements for Non-Cleared Swaps (May 2020), *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download* ("GMAC Subcommittee Report" or "Report"). The Global Markets Advisory Committee ("GMAC") established the GMAC Subcommittee to consider issues raised by the implementation of margin requirements for non-cleared swaps, to identify challenges associated with forthcoming implementation phases, and to make recommendations through a report. The GMAC Subcommittee issued the GMAC Subcommittee Report recommending various actions, including the codification of Letters 17-12 and 19-25. The GMAC adopted the Report and recommended to the Commission that it consider adopting the Report's recommendations.

[19] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 85 FR 59470 (Sept. 22, 2020).

[20] Comments were submitted by the following entities: American Council of Life Insurers ("ACLI"); Futures Industry Association ("FIA"); Investment Company Institute ("ICI"); ISDA, Global Foreign Exchange Division ("GFXD") of the Global Financial Markets Association ("GFMA"), and Securities Industry and Financial Markets Association ("SIFMA") in a joint letter ("ISDA/GFMA/SIFMA"); Managed Funds Association ("MFA"); and SIFMA AMG. The comment letters are available at *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=4155*.

changes.[21] Several commenters highlighted the importance of the regulatory certainty that the adoption of regulations consistent with existing no-action relief would bring.[22]

The comments confirm the rationale articulated for the Proposal. As such, the Commission is adopting the amendments to Regulations 23.151, 23.152(b)(3), 23.153(c) and 23.158(a), as proposed.

A. Application of MTA to SMAs

The Commission is adopting the proposed amendment to the definition of MTA in Regulation 23.151 to allow a CSE to apply an MTA of up to $50,000 to each SMA owned by a counterparty with whom the CSE enters into uncleared swaps. The amendment is consistent with the terms of Letter 17-12, which provides that DSIO would not recommend enforcement action if an SD applies an MTA no greater than $50,000 to each SMA of a legal entity, subject to certain conditions.

As discussed in the Proposal, when the Commission adopted the CFTC Margin Rule, it rejected the notion that SMAs of a legal entity should be treated separately from each other in applying certain aspects of the margin requirements for uncleared swaps.[23] However, after implementing the margin requirements for several years, and in particular, administering the application of the MTA, including the staff's issuance of Letter 17-12, the Commission believes that separately treating SMAs, at least with respect to the application of the MTA, is appropriate from an operational perspective.

The Commission notes, as discussed in the Proposal, that certain owners of SMAs, such as pension funds, in administering investments for beneficiaries, may engage in collateral management exercises and may have the capability to aggregate collateral

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[21] *See* ACLI at 1; FIA at 4.
[22] *See* ISDA/GFMA/SIFMA at 2; SIFMA AMG at 4.
[23] *See* 81 FR at 653 (rejecting commenters' request to extend to each separate account of a fund or plan its own initial margin threshold, while acknowledging that separate managers acting for the same fund or plan may not take steps to inform the fund or plan of their uncleared swap exposures on behalf of their principal on a frequent basis).

across their SMAs. As such, a beneficial owner may be able to aggregate the MTA across its SMAs that trade with a particular CSE and centralize the management of collateral for the SMAs, which may result in increased netting among the SMAs and the CSE, and more efficient collateral management. However, the Commission points out that other SMA owners may not have such capability because, as noted in the GMAC Subcommittee Report, the SMA owners may not be able to coordinate trading activity across their SMAs, given that they typically grant full investment discretion to their asset managers and do not employ a centralized collateral manager in-house.[24]

In theory, while asset managers could coordinate with each other the calculation of the MTA across SMAs under their management, the Commission believes that accepted market practice may preclude the sharing of information among asset managers. In this regard, the Commission notes that the GMAC Subcommittee Report stated that owners of SMAs typically prohibit information sharing among their SMAs and require asset managers to keep trading information confidential, with the result that asset managers lack transparency and control over the assets of the SMA owner other than the specific assets under their management.

The Commission requested comment on the feasibility of coordination among asset managers. Several commenters, consistent with the GMAC Subcommittee Report's findings, indicated that confidentiality requirements and logistical impediments prevent asset managers from aggregating IM and VM obligations across SMAs for purposes of determining whether the MTA threshold has been exceeded, rendering the application of a single MTA across SMAs impractical.[25] Commenters further asserted that the ability to

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[24] GMAC Subcommittee Report at 16.

[25] *See* ICI at 6; ISDA/GFMA/SIFMA at 2; SIFMA AMG at 3. *See also* MFA at 3 (noting that the amendment to the MTA definition would eliminate the significant burden of requiring multiple asset managers running SMAs for the same SMA owner to coordinate the calculation of the MTA among them).

apply a separate MTA to each SMA is critical for asset managers that provide services to clients through an SMA structure.[26]

Likewise, the Commission believes that confidentiality requirements may also preclude communications between a CSE and individual asset managers of SMAs of an owner concerning the owner's overall trading activity. As discussed in the GMAC Subcommittee Report, a duty of confidentiality to the legal entity may prevent a CSE from sharing information across the asset managers of SMAs of a legal entity.[27] As a result, even though each SMA of an owner may contribute to reaching the MTA limit, asset managers for the SMAs may only know the amounts of IM and VM being contributed by SMAs under their management.

In light of the practical challenges that the calculation of the MTA across SMAs poses, as described above, the Commission is amending Regulation 23.151 to allow CSEs to apply an MTA of up to $50,000 for each SMA of a counterparty. The Commission notes, however, that under this application of the MTA to SMAs, as adopted, an MTA of up to $50,000 could be applied to an indefinite number of SMAs. This application of the MTA would effectively replace the aggregate limit of $500,000 for a particular counterparty's uncollateralized risk for uncleared swaps with an individual limit of $50,000 for each SMA of such counterparty. In turn, the counterparty could have an aggregate amount of uncollateralized risk in excess of $500,000.

This application of the MTA to SMAs could incentivize owners of SMAs to create separate accounts by formulating trading strategies to reduce or avoid margin transfers. However, the Commission believes that the inability to net collateral across

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[26] *See, e.g.*, ICI at 6.

[27] The Commission notes that Regulation 23.410(c)(1)(i) prohibits disclosure by an SD or MSP, including a CSE, of confidential information provided by or on behalf of a counterparty to the SD or MSP. Nevertheless, Regulation 23.410(c)(2) provides that the SD or MSP may disclose the counterparty's confidential information if the disclosure is authorized in writing by the counterparty.

separate accounts would stem the indiscriminate creation of SMAs[28] because the MTA for SMAs, as adopted in this Final Rule, is set at a low level (*i.e.*, $50,000), and any potential benefits resulting from the avoidance of margin transfers would become less meaningful, as the fragmentation of an owner's investments among SMAs would reduce the ability to aggregate swaps positions and net collateral.

Several commenters agreed with the Commission's view that the potential risk of an increase in the amount of uncollateralized margin is mitigated by, among other safeguards, the low MTA thresholds and the limitations on netting across separate accounts.[29] The commenters further noted that the costs and practical challenges associated with establishing and maintaining SMAs are significant and would likely override the benefit of a marginal MTA increase.[30] One commenter also argued that it is extremely unlikely that an asset manager could coordinate its activities with other SMA managers to minimize the SMA owner's margin requirements, given that asset managers typically exercise discretion over a portion of the SMA's assets and maintain confidentiality with respect to the SMA's trading activity.[31] Another commenter pointed out that the requirement that the SMAs' asset managers must be granted authority over assets under their management under the investment management agreement[32] creates practical as well as cost challenges that would further disincentivize the creation of unnecessary SMAs.[33]

The Commission further notes that there are other provisions in the CEA and the Commission's regulations that would mitigate the increase in uncollateralized credit risk

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[28] As further discussed below, the application of the MTA, as provided in this Final Rule, is only available for separate accounts of an owner that, consistent with the definition of SMA, as adopted by the Final Rule, are not subject to collateral agreements that provide for netting across separate accounts.
[29] *See* ICI at 7; MFA at 3; SIFMA AMG at 4.
[30] *See* ICI at 7, MFA at 3.
[31] *See* ICI at 7.
[32] As further discussed below, the Final Rule defines the term SMA as an account managed by an asset manager pursuant to a specific grant of authority to such asset manager under an investment management agreement between the counterparty and the asset manager with respect to a specified portion of the counterparty's assets.
[33] *See* SIFMA AMG at 4.

resulting from the absence of an aggregate limit in the MTA. Specifically, section 4s(j)(2) of the CEA requires CSEs to adopt a robust and professional risk management system adequate for the management of their swap activities,[34] and Regulation 23.600[35] mandates that CSEs establish a risk management program to monitor and manage risks associated with their swap activities that includes, among other things, a description of risk tolerance limits.

The Commission is also amending Regulation 23.151 to add a definition for the term SMA. The new definition of SMA uses the definition of the term set forth in Letter 17-12. As adopted, the term SMA is defined as an account of a counterparty to a CSE that is managed by an asset manager pursuant to a specific grant of authority to such asset manager under an investment management agreement between the counterparty and the asset manager, with respect to a specified portion of the counterparty's assets.[36] The definition requires that the swaps of the SMA (i) be entered into between the counterparty and the CSE by the asset manager pursuant to authority granted by the counterparty to the asset manager through an investment management agreement; and (ii) be subject to a master netting agreement that does not provide for the netting of IM or VM obligations across all SMAs of the counterparty that have swaps outstanding with the CSE.

The definition of SMA is designed to limit the application of the MTA, as prescribed by the Final Rule, to SMAs that have dedicated netting sets under the SMAs' ISDA master agreements and CSAs, or are otherwise precluded from netting collateral across SMAs, and that are administered by asset managers with authority that is limited to assets specifically under their management. The Commission notes that the limited authority of asset managers over the assets of a legal entity and the practical inability to

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[34] *See* 7 U.S.C. 6s(j).
[35] 17 CFR 23.600.
[36] The definition of the term SMA, as adopted, refers to the aggregate account of a counterparty managed by an asset manager under the investment management agreement, and not to fund or pool sleeves overseen by sub-advisers.

net collateral payments across SMAs pose obstacles in the calculation and aggregation of the MTA across SMAs that this Final Rule is designed to address.

B. Application of Separate MTAs for IM and VM

The Commission is revising the margin documentation requirements outlined in Regulation 23.158(a), consistent with Letter 19-25, to recognize that a CSE can apply separate MTAs for IM and VM with each counterparty in determining whether IM or VM or both must be posted or collected with a counterparty under Regulation 23.152 (requiring CSEs to exchange IM with a counterparty) or Regulation 23.153 (requiring CSEs to exchange VM with a counterparty). Regulation 23.158(a), as amended, states that if a CSE and its counterparty agree to have separate MTAs for IM and VM, the MTAs corresponding to IM and VM must be specified in the margin documentation required by Regulation 23.158, and the MTAs, on a combined basis, must not exceed the MTA specified in Regulation 23.151.

The Commission believes that the amendment to Regulation 23.158(a) accommodates a widespread market practice that facilitates the implementation of the CFTC margin requirements. In administering the application of the MTA, including the issuance of Letter 19-25, the Commission has recognized that, as a practical matter, CSEs and their counterparties maintain separate settlement workflows for IM and VM and agree to separate MTAs in each of their IM and VM CSAs, which, combined, do not exceed $500,000. These separate settlement workflows for IM and VM reflect, from an operational perspective, the different segregation requirements applicable to IM and VM under the CFTC Margin Rule.[37]

The Commission acknowledges that the amendment to Regulation 23.158(a) may result in the exchange of less margin than the amount that would be exchanged if the

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[37] *See* 17 CFR 23.157 (requiring IM to be segregated with an independent custodian. The CFTC Margin Rule does not impose similar segregation requirements with respect to VM).

MTA were computed on an aggregate basis.[38] However, the Commission notes that because the total amount of combined IM and VM that would not be exchanged would generally not exceed $500,000, the differences in the total margin exchanged would not be material and would not result in an unacceptable level of credit risk. While the MTA as applied to SMAs, pursuant to the amendments to Regulation 23.151, may result in an aggregate MTA that exceeds $500,000, the Commission nonetheless believes that the increased level of uncollateralized risk that might result from the application of the MTA to SMAs will be mitigated because the MTA levels applicable to SMAs are set at a very low level (*i.e.*, $50,000), which would reduce the incentive for SMA owners to create additional SMAs to avoid the transfer of margin given the inability to net collateral across SMAs, as provided by the Final Rule.

The Commission believes, consistent with the views expressed by DSIO staff in issuing Letter 19-25, that the application of separate MTAs for IM and VM, subject to certain conditions, will reduce the cost and burdens associated with the transfer of small margin balances, without undermining the Commission's objective of requiring swap counterparties to protect themselves by mitigating their credit and market risks. The Commission further notes that similar applications of the MTA are permitted in certain foreign jurisdictions, including the European Union.[39] The amendment to Regulation 23.158(a) therefore promotes consistent regulatory standards across jurisdictions, in line

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[38] Letter 19-25 describes the application of separate MTAs for IM and VM with the following illustration: An SD and a counterparty agree to a $300,000 IM MTA and a $200,000 VM MTA. If the margin calculations set forth in Commission regulations 23.154 (for IM) and 23.155 (for VM) require the SD to post $400,000 of IM with the counterparty and $150,000 of VM with the counterparty, the SD will be required to post $400,000 of IM with the counterparty (assuming that the $50 million IM threshold amount, defined in Commission regulation 23.151, for the counterparty has been exceeded). The SD, however, will not be obligated to post any VM with the counterparty as the $150,000 requirement is less than the $200,000 MTA. By contrast, in the absence of relief, the SD would have been required to post $550,000 (the full amount of both IM and VM), given that the combined amount of IM and VM exceeds the MTA of $500,000.

[39] *See* Commission Delegated Regulation (EU) 2016/2251 Supplementing Regulation (EU) No. 648/2012 of the European Parliament and of the Council of July 4, 2012 on OTC Derivatives, Central Counterparties and Trade Repositories with Regard to Regulatory Technical Standards for Risk-Mitigation Techniques for OTC Derivative Contracts Not Cleared by a Central Counterparty (Oct. 4, 2016), Article 25(4), *https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R2251&from=EN*.

with the statutory mandate set forth in the Dodd-Frank Act[40] and reduces the need for market participants to create and implement IM and VM settlement flows tailored to different jurisdictions.

A number of commenters confirmed the Commission's understanding that the application of separate MTAs for IM and VM facilitates compliance with the CFTC Margin Rule.[41] Commenters noted that if swap counterparties were required to apply a single combined MTA, they would need to implement significant changes to the documentation and operational processes.[42] In particular, ICI noted that in the absence of Letter 19-25 and this Final Rule, counterparties would have to reconcile two operational processes: margin calculation protocols that account for a combined MTA and separate workflows that exist for IM and VM settlement in light of the Commission's segregation requirements, which differentiate treatment for IM and VM. [43]

Several commenters expressed support for extending the application of separate MTAs for IM and VM to SMAs for which an MTA of up to $50,000 would be applicable, noting that the stated rationale for proposing the revisions to Regulation 23.158(a) applies equally to SMAs and that allowing such application would establish a consistent regulatory approach to applying MTA thresholds.[44] In addition, noting some ambiguity, SIFMA AMG urged the Commission to confirm that the ability to apply separate MTAs for IM and VM would extend to SMAs.[45] In response, the Commission confirms that the amendments to Regulations 23.151 and 23.158(a), as adopted, permit a CSE to apply separate MTAs for IM and VM with each counterparty, or an SMA of a counterparty, provided the MTAs, on a combined basis, do not exceed the respective

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[40] *See* section 752 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010), calling on the CFTC to consult and coordinate on the establishment of consistent international standards with respect to the regulation of swaps.
[41] *See* ACLI at 2; MFA at 4; SIFMA AMG at 4.
[42] *See e.g.*, ACLI at 2.
[43] *See* ICI at 8.
[44] *See* ICI at 9; MFA at 4.
[45] *See* SIFMA AMG at 4.

limits set by Regulation 23.151. The Commission notes that the text of the amendment to Regulation 23.158(a) refers to Regulation 23.151, which, as amended, defines MTA and provides for the application of an MTA of up to $50,000 for each SMA of a counterparty, thus allowing for the application of separate amounts of IM and VM to the MTA of an SMA, as provided in amended Regulation 23.151.

C. Conforming Changes

Consistent with the amendment to the definition of MTA in Regulation 23.151, the Commission is adopting conforming changes to Regulations 23.152(b)(3) and 23.153(c) by replacing "$500,000" with "the minimum transfer amount, as the term is defined in 23.151." The changes replace the reference to $500,000 in current Regulations 23.152(b)(3) and 23.153(c), which effectively limits the MTA to $500,000, with a reference to the revised definition of MTA, which allows for the application of an MTA of up to $50,000 for each SMA.

III. Administrative Compliance

The Regulatory Flexibility Act ("RFA") requires Federal agencies to consider whether the rules they propose will have a significant economic impact on a substantial number of small entities.[46] As discussed in the Proposal, the amendments being adopted herein only affect certain SDs and MSPs and their counterparties, which must be eligible contract participants ("ECPs").[47] The Commission has previously established that SDs, MSPs and ECPs are not small entities for purposes of the RFA.[48] Therefore, the Commission believes that the Final Rule will not have a significant economic impact on a substantial number of small entities, as defined in the RFA.

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[46] 5 U.S.C. 601 *et seq*.
[47] Pursuant to section 2(e) of the CEA, 7 U.S.C. 2(e), each counterparty to an uncleared swap must be an ECP, as defined in section 1a(18) of the CEA, 7 U.S.C. 1a(18).
[48] *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "'Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596, 30701 (May 23, 2012).

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the Final Rule will not have a significant economic impact on a substantial number of small entities.

A. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA")[49] imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. The Commission may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget control number. The Final Rule, as adopted, contains no requirements subject to the PRA.

B. Cost-benefit considerations

Section 15(a) of the CEA[50] requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) considerations.

The Commission is amending Regulation 23.151 consistent with Letter 17-12. The Commission is revising the definition of MTA in Regulation 23.151 to permit CSEs to apply an MTA of up to $50,000 for each SMA of a counterparty that enters into uncleared swaps with a CSE. The Commission also is amending Regulation 23.151 to

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[49] 44 U.S.C. 3501 *et seq*.
[50] 7 U.S.C. 19(a).

add a definition for the term SMA (or separately managed account). The Commission is also revising Regulation 23.158(a) consistent with Letter 19-25 to state that if a CSE and its counterparty agree to have separate MTAs for IM and VM, the respective amounts of MTA must be reflected in the margin documentation required by Regulation 23.158(a). Finally, the Commission is adopting conforming changes to Regulations 23.152(b)(3) and 23.153(c) to incorporate the change to the definition of MTA in Regulation 23.151.

The baseline for the Commission's consideration of the costs and benefits of this Final Rule is the CFTC Margin Rule. The Commission recognizes that to the extent market participants have relied on Letters 17-12 and 19-25, the actual costs and benefits of the amendments, as realized in the market, may not be as significant.

The Commission notes that the consideration of costs and benefits below is based on the understanding that the markets function internationally, with many transactions involving U.S. firms taking place across international boundaries; with some Commission registrants being organized outside of the United States; with leading industry members typically conducting operations both within and outside the United States; and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the following discussion of costs and benefits refers to the effects of the Final Rule on all activity subject to the amended regulations, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with activities in, or effect on, U.S. commerce under section 2(i) of the CEA.[51]

As previously discussed, the Commission received six comment letters expressing support for the Proposal. Commenters generally noted that the proposed amendments are beneficial for market participants and characterized them as helpful and practical accommodations that reflect the realities of the marketplace and facilitate compliance

[51] 7 U.S.C. 2(i).

with the CFTC Margin Rule. Several commenters elaborated on specific benefits of the amendments, noting for instance that the amendments would eliminate burdens associated with the application of a single MTA across SMAs of a counterparty, provide regulatory certainty and contribute to global consistency in regulatory standards. Some commenters also addressed concerns that the Commission had raised in the Proposal, pointing out mitigating factors.[52]

1. Benefits

The amendments to Regulation 23.151 allow CSEs to apply an MTA of up to $50,000 to SMAs of a counterparty. Under the current requirements, a CSE must apply the MTA with respect to each counterparty to an uncleared transaction. As a result, in the context of a counterparty that has multiple SMAs through which uncleared swaps are traded, with each SMA potentially giving rise to IM and VM obligations, the amounts of IM and VM attributable to the SMAs of the counterparty must be aggregated to determine whether the MTA has been exceeded, which would require the exchange of IM or VM.

As previously discussed, because the assets of SMAs are separately held, transferred, and returned at the account level, and CSEs and SMA asset managers do not share trading information across SMAs, aggregation of IM and VM obligations across SMAs for the purpose of determining whether the MTA has been exceeded may be impractical, hindering efforts to comply with the CFTC Margin Rule. The Commission acknowledges, however, the possibility that, in certain contexts, an owner of SMAs, such as a pension fund that administers investments for beneficiaries, may be set up to perform collateral management exercises and may have the capability to aggregate collateral

[52] *See e.g.*, ICI at 7 and MFA at 3 (addressing the concern that permitting the application of a reduced, individualized MTA, as proposed, to an indefinite number of SMAs may incentivize SMA owners to create additional separate accounts).

across SMAs. Nevertheless, according to industry feedback, the only practical alternative to fully ensure compliance with the margin requirements is to set the MTA for each SMA at zero, so that trading by a given SMA does not result in an inadvertent breach of the aggregate MTA threshold without the exchange of the required margin.

The amendments to Regulation 23.151, by allowing the application of an MTA of up to $50,000 for each SMA of a counterparty, will ease the operational burdens and transactional costs associated with managing frequent transfers of small amounts of collateral that counterparties would incur if the MTA for SMAs were to be set at zero. In addition, the amendments give flexibility to CSEs, owners of SMAs, and asset managers to negotiate MTA levels within the regulatory limits that match the risks of the SMAs and their investment strategies, and the uncleared swaps being traded.

Furthermore, because the amendments to Regulation 23.151 simplify the application of the MTA in the SMA context, thereby reducing the operational burden, market participants may be encouraged to participate in the uncleared swap markets through managed accounts, and account managers may also make their services more readily available to clients. As a result, trading in the uncleared swap markets may increase, promoting competition and liquidity.

The amendment of Regulation 23.158(a) could likewise lead to efficiencies in the application of the MTA. The amendment, as adopted, states that if a CSE and its counterparty agree to have separate MTAs for IM and VM, the respective amounts of MTA must be reflected in the margin documentation required by Regulation 23.158(a). CSEs will thus be able to maintain separate margin settlement workflows for IM and VM to address the differing segregation treatments for IM and VM under the CFTC Margin Rule.

The Commission notes that the application of separate MTAs for IM and VM has been adopted in other jurisdictions, including the European Union, and the practice is widespread. The amendments, by aligning the CFTC with other jurisdictions with respect to the application of the MTA, advance the CFTC's goal of promoting consistent international standards, in line with the statutory mandate set forth in the Dodd-Frank Act.

Finally, the amendments, as adopted, provide certainty to market participants who may have relied on Letters 17-12 and 19-25, and could thereby facilitate their efforts to take the operation of the Commission's regulations into account in the planning of their uncleared swap activities.

2. Costs

The amendments to Regulation 23.151 could result in a CSE applying an MTA that exceeds, in the aggregate, the current MTA limit of $500,000. That is because the amendments, as adopted, permit the application of an MTA of up to $50,000 for each SMA of a counterparty, without limiting the number of SMAs to which the $50,000 threshold may be applied. The amendments thus could incentivize SMA owners to increase the number of separate accounts in order to benefit from the higher MTA limit. As a result, the collection and posting of margin for some SMAs may be delayed, since margin will not need to be exchanged until the MTA threshold is exceeded, which could result in the exchange of less collateral to mitigate the risk of uncleared swaps.

The amendment to Regulation 23.158(a), as adopted, states that if a CSE and its counterparty agree to have separate MTAs for IM and VM, the respective amounts of MTA must be reflected in the margin documentation required by Regulation 23.158(a). The amendment recognizes that CSEs can apply separate MTAs for IM and VM for determining whether Regulations 23.152(b)(3) and 23.153(c) require the exchange of IM or VM. The Commission acknowledges that the application of separate IM and VM MTAs may result in the exchange of a lower amount of total margin between a CSE and its counterparty to mitigate the risk of their uncleared swaps than the amount that would be exchanged if the IM and VM MTA were computed on an aggregate basis.[53] The Commission notes that this cost may be mitigated because the application of separate IM and VM MTAs could also result in the exchange of higher rather than lower amounts of margin.[54]

While the Commission recognizes that the uncollateralized exposure that may result from amending Regulations 23.151 and 23.158(a), in line with Letters 17-12 and 19-25, could increase credit risk associated with uncleared swaps, the Commission believes that a number of safeguards exist to mitigate this risk. The Commission notes that the amendments, as adopted, set the MTA at low levels. When the MTA is applied to a counterparty, the sum of the IM and VM MTAs must not exceed $500,000. When the MTA is applied to an SMA of a counterparty, the sum of the IM and VM MTAs must not exceed $50,000. In particular with respect to the application of the MTA to SMAs, the low level of the MTA may dampen the incentive to create additional SMAs to benefit from the potentially higher MTA threshold given the inability to net collateral across SMAs under the Final Rule. Several commenters confirmed the Commission's assessment and some added that the burdens and costs of creating and maintaining separate accounts would likely override the benefits of any marginal increase in MTA.[55] Also, the Commission notes that other regulatory safeguards exist that would limit the potential increase in the credit exposure, including section 4s(j)(2) of the CEA,[56] which mandates that CSEs adopt a robust and professional risk management system adequate

[53] *Supra* note 38 (explaining how the application of separate MTAs for IM and VM could result in the exchange of lower amounts of margin than if IM and VM MTA were computed on an aggregate basis).
[54] The following illustration explains how the application of separate MTAs for IM and VM could result in the exchange of higher amounts of margin than if IM and VM MTA were computed on an aggregate basis: An SD and a counterparty agree to $300,000 IM MTA, and $200,000 VM MTA. If the margin calculations set forth in Commission regulations 23.154 (for IM), and 23.155 (for VM) require the SD to post $200,000 of IM with the counterparty and $250,000 of VM with the counterparty, the SD would not be required to post IM with the counterparty as the $200,000 requirement is less than the $300,000 MTA. However, the SD would be required to post $250,000 in VM as the VM required exceeds the $200,000 VM MTA, even though the total amount of margin owed is below the $500,000 MTA set forth in Commission regulations 23.152(b)(3) and 23.153(c). Letter 19-25 at 4.
[55] *See* ICI at 7; MFA at 3; SIFMA AMG at 3.
[56] 7 U.S.C. 6s(j)(2).

for the management of day-to-day swap activities, and Regulation 23.600,[57] which requires CSEs, in establishing a risk management program for the monitoring and management of risk related to their swap activities, to account for credit risk and to set risk tolerance limits.

3. Section 15(a) Considerations

In light of the foregoing, the CFTC has evaluated the costs and benefits of the Final Rule pursuant to the five considerations identified in section 15(a) of the CEA as follows:

a. Protection of Market Participants and Public

As discussed above, the amendments to Regulations 23.151 and 23.158(a), which address the application of the MTA to SMAs and the application of separate MTAs for IM and VM, remove practical burdens in the application of the MTA, facilitating the implementation of the CFTC Margin Rule, with minimal impact on the protection of market participants and the public in general. Although the amendments, as adopted, could result in larger amounts of MTA being applied to uncleared swaps, potentially resulting in the exchange of reduced margin to offset the risk of uncleared swaps, the impact is likely to be negligible relative to the size of the uncleared swap positions. The Commission notes that the MTA thresholds are set at low levels. In addition, CSEs are required to monitor and manage risk associated with their swaps, in particular credit risk, and to set tolerance levels as part of the risk management program mandated by Regulation 23.600. To meet the risk tolerance levels, a CSE may contractually limit the MTA or the number of SMAs for a particular counterparty with whom the CSE enters into uncleared swap transactions.

b. Efficiency, Competitiveness, and Financial Integrity of Markets

[57] 17 CFR 23.600.

By amending Regulation 23.151 to allow CSEs to apply an MTA of up to $50,000 for each SMA of a counterparty, the Commission eliminates burdens and practical challenges associated with the computation and aggregation of the MTA across multiple SMAs. In addition, the new MTA threshold for SMAs could have the effect of delaying how soon margin would be exchanged, as the aggregate MTA for SMAs is no longer limited to $500,000.

The simplification of the process for applying the MTA to SMAs and the reduced cost that may be realized from the deferral of margin obligations may encourage market participants to enter into uncleared swaps through accounts managed by asset managers and also encourage asset managers to accept more clients. The amendments to Regulation 23.151 could therefore foster competitiveness by encouraging increased participation in the uncleared swap markets.

The amendment to Regulation 23.158(a) states that if a CSE and its counterparty agree to have separate MTAs for IM and VM, the respective amounts of MTA must be reflected in the margin documentation required by Regulation 23.158(a). The amendment recognizes that CSEs can apply separate MTAs for IM and VM, enabling CSEs to accommodate the different segregation treatments for IM and VM under the CFTC's margin requirements and to more efficiently comply with the CFTC Margin Rule.

The amendments to Regulations 23.151 and 23.158(a) could have the overall effect of permitting larger amounts of MTA being applied to uncleared swaps, resulting in the collection and posting of less collateral to offset the risk of uncleared swaps, which could undermine the integrity of the markets. The Commission, however, believes that the uncollateralized swap exposure will be limited given that the MTA thresholds are set at low levels, and there are other built-in regulatory safeguards, such as the requirement that CSEs establish a risk management program under Regulation 23.600 that provides for the implementation of internal risk parameters for the monitoring and management of swap risk.

The Commission also notes that the amendments provide certainty to market participants who may have relied on Letters 17-12 and 19-25, and thereby facilitate their efforts to take the operation of the Commission's regulations into account in planning their uncleared swap activities.

c. Price Discovery

The amendments to Regulations 23.151 and 23.158(a) simplify the process for applying the MTA, reducing the burden and cost of implementation. Given these cost savings, CSEs and other market participants may be encouraged to increase their participation in the uncleared swap markets. As a result, trading in uncleared swaps may increase, leading to increased liquidity and enhanced price discovery.

d. Sound Risk Management

Because the amendments to Regulations 23.151 and 23.158(a) permit the application of larger amounts of MTA, less margin may be collected and posted to offset the risk of uncleared swaps. Nevertheless, the Commission believes that the risk is mitigated because the regulatory MTA thresholds are set at low levels, and CSEs are required to have a risk management program that provides for the implementation of internal risk management parameters for the monitoring and management of swap risk.

The Commission also notes that the amendments simplify the application of the MTA, reducing the burden and cost of implementation, without leading to an unacceptable level of uncollateralized credit risk. Such reduced burden and cost could encourage market participants to increase their participation in the uncleared swap markets, potentially facilitating improved risk management for counterparties using uncleared swaps to hedge risks. Moreover, by facilitating compliance with certain aspects of the Commission's regulations, the Commission allows market participants to focus their efforts on monitoring and ensuring compliance with other substantive aspects of the CFTC Margin Rule, thus promoting balanced and sound risk management.

e. Other Public Interest Considerations

The amendment to Regulation 23.158(a) addresses the application of separate MTAs for IM and VM, contributing to the CFTC's alignment with other jurisdictions, such as the European Union, which advances the CFTC's efforts to achieve consistent international standards. The CFTC's alignment with other jurisdictions with respect to the application of the MTA will benefit CSEs that are global market participants by eliminating the need to establish different settlement workflows tailored to each jurisdiction in which they operate.

C. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of the CEA, as well as the policies and purposes of the CEA, in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of the CEA.[58]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requested comment on whether the Proposal implicated any other specific public interest to be protected by the antitrust laws and received no comments.

The Commission has considered the Final Rule to determine whether it is anticompetitive and has identified no anticompetitive effects. The Commission requested

[58] 7 U.S.C. 19(b).

comment on whether the Proposal was anticompetitive and, if it was, what the anticompetitive effects were, and received no comments.

Because the Commission has determined that the Final Rule is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR Part 23 as set forth below:

List of Subjects 17 CFR Part 23

Swaps, Swap dealers, Major swap participants, Capital and margin requirements.

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

1. The authority citation for part 23 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b-1,6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

2. Amend § 23.151 by:

a. Revising the definition of "minimum transfer amount"; and

b. Adding in alphabetical order a definition for "separately managed account".

The revision and addition read as follows:

§ 23.151 Definitions applicable to margin requirements.

* * * * *

Minimum transfer amount means a combined initial and variation margin amount under which no actual transfer of funds is required. The minimum transfer amount shall be $500,000. Where a counterparty to a covered swap entity owns two or more separately managed accounts, a minimum transfer amount of up to $50,000 may be applied for each separately managed account.

* * * * *

Separately managed account means an account of a counterparty to a covered swap entity that meets the following requirements:

(1) The account is managed by an asset manager and governed by an investment management agreement, pursuant to which the counterparty grants the asset manager authority with respect to a specified amount of the counterparty's assets;

(2) Swaps are entered into between the counterparty and the covered swap entity by the asset manager on behalf of the account pursuant to authority granted by the counterparty through an investment management agreement; and

(3) The swaps of such account are subject to a master netting agreement that does not provide for the netting of initial or variation margin obligations across all such accounts of the counterparty that have swaps outstanding with the covered swap entity.

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3. Amend § 23.152 by revising paragraph (b)(3) to read as follows:

§ 23.152 Collection and posting of initial margin.

* * * * *

(b) * * *

(3) *Minimum transfer amount.* A covered swap entity is not required to collect or to post initial margin pursuant to §§ 23.150 through 23.161 with respect to a particular counterparty unless and until the combined amount of initial margin and variation margin that is required pursuant to §§ 23.150 through 23.161 to be collected or posted and that has not been collected or posted with respect to the counterparty is greater than the minimum transfer amount, as the term is defined in § 23.151.

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4. Amend § 23.153 by revising paragraph (c) to read as follows:

§ 23.153 Collection and posting of variation margin.

* * * * *

(c) *Minimum transfer amount.* A covered swap entity is not required to collect or to post variation margin pursuant to §§ 23.150 through 23.161 with respect to a particular counterparty unless and until the combined amount of initial margin and variation margin that is required pursuant to §§ 23.150 through 23.161 to be collected or posted and that has not been collected or posted with respect to the counterparty is greater than the minimum transfer amount, as the term is defined in § 23.151.

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5. Amend § 23.158 by revising paragraph (a) to read as follows:

§ 23.158 Margin documentation.

(a) *General requirement.* Each covered swap entity shall execute documentation with each counterparty that complies with the requirements of § 23.504 and that complies with this section, as applicable. For uncleared swaps between a covered swap entity and a counterparty that is a swap entity or a financial end user, the documentation shall provide the covered swap entity with the contractual right and obligation to exchange initial margin and variation margin in such amounts, in such form, and under such circumstances as are required by §§ 23.150 through 23.161. With respect to the minimum transfer amount, if a covered swap entity and a counterparty that is a swap entity or a financial end user agree to have separate minimum transfer amounts for initial and variation margin, the documentation shall specify the amounts to be allocated for initial margin and variation margin. Such amounts, on a combined basis, must not exceed the minimum transfer amount, as the term is defined in § 23.151.

* * * * *

Issued in Washington, DC on December 9, 2020, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Voting Summary and Chairman's and Commissioners' Statements

Appendix 1—Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Supporting Statement of Commissioner Dawn D. Stump

Overview

I am pleased to support the final rulemaking that the Commission is adopting with respect to the "minimum transfer amount" provisions of its margin requirements for uncleared swaps.

This rulemaking addresses recommendations that the Commission has received from its Global Markets Advisory Committee ("GMAC"), which I am proud to sponsor, and is based on a comprehensive report prepared by GMAC's Subcommittee on Margin Requirements for Non-Cleared Swaps ("GMAC Margin Subcommittee").[1] It demonstrates the value added to the Commission's policymaking by its Advisory Committees, in which market participants and other interested parties come together to provide us with their perspectives and potential solutions to practical problems.

The rulemaking we are adopting makes two changes to the Commission's uncleared margin rules, which have much to commend them – indeed, we did not receive any comment letters opposing them. These rule changes further objectives that I have commented on before:

- the need to tailor our rules to assure that they are workable for those required to comply with them; and
- the benefits of codifying relief that has been issued by our Staff and re-visiting our rules, where appropriate.

A Different Universe is Coming into Scope of the Uncleared Margin Rules

The Commission's uncleared margin rules for swap dealers, like the Framework of the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions ("BCBS/IOSCO")[2] on which they are based,

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[1] *Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps,* Report to the CFTC's Global Markets Advisory Committee by the Subcommittee on Margin Requirements for Non-Cleared Swaps (April 2020), available at *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download*.
[2] *See generally* BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives (July 2019), available *at https://www.bis.org/bcbs/publ/d475.pdf*.

were designed primarily to ensure the exchange of margin between the largest, most systemic, and interconnected financial institutions for their uncleared swap transactions with one another. Today, these institutions and transactions are subject to uncleared margin requirements that have taken effect since the rules were adopted.

Pursuant to the phased implementation schedule of the Commission's rules and the BCBS/IOSCO Framework, though, a different universe of market participants – presenting unique considerations – will soon be coming into scope of the margin rules. It is only now, as we enter the final phases of the implementation schedule, that the Commission's uncleared margin rules will apply to a significant number of financial end-users, and we have a responsibility to make sure they are fit for that purpose. Accordingly, now is the time we must thoughtfully consider whether the regulatory parameters that we have designed for the largest financial institutions in the earlier phases of margin implementation need to be tailored to account for the practical and operational challenges posed by the exchange of margin when one of the counterparties is a pension plan, endowment, insurance provider, mortgage service provider, or other financial end-user.

This rulemaking regarding the minimum transfer amount ("MTA") does exactly that. The Commission's uncleared margin rules provide that a swap dealer is not required to collect or post initial margin ("IM") or variation margin ("VM") with a counterparty until the combined amount of such IM and VM exceeds the MTA of $500,000. Yet, the application of the MTA presents a significant operational challenge for institutional investors that typically hire asset managers to exercise investment discretion over portions of their assets in separately managed accounts ("SMAs") for purposes of diversification. As a practical matter, neither the owner of the SMA, the manager of the assets in the SMA, nor the swap dealer that is a counterparty to the SMA is in a position to readily determine when the MTA has been exceeded on an aggregate basis (or to assure that it is not).

To address this challenge, the Commission is amending the definition of MTA in its margin rules to allow a swap dealer to apply an MTA of up to $50,000 to each SMA owned by a counterparty with which the swap dealer enters into uncleared swaps. As noted in the release, any potential increase in uncollateralized credit risk as a result would be mitigated both by the conditions set out in the rules we are adopting, as well as existing safeguards in the Commodity Exchange Act ("CEA") and the Commission's regulations.[3]

This is a sensible approach and an appropriate refinement to make the Commission's uncleared margin rules workable for SMAs given the realities of the modern investment management environment. As I have stated before, no matter how well-intentioned a rule may be, if it is not workable, it cannot deliver on its intended purpose.[4]

The Benefits of Codifying Staff Relief and Re-Visiting our Rules

Application of MTA to SMAs: The rule change that I have discussed above regarding the application of the MTA to SMAs would codify no-action relief in Letter No. 17-12 that our Staff issued in 2017.[5] The Commission's Staff often has occasion to issue relief or take other action in the form of no-action letters, interpretative letters, or advisories on various issues and in various circumstances. This affords the Commission a chance to observe how the Staff action operates in real-time, and to evaluate lessons

[3] Specifically, CEA Section 4s(j)(2), 7 U.S.C. 6s(j)(2), requires swap dealers to adopt a robust risk management system adequate for the management of their swap activities, and CFTC Rule 23.600, 17 CFR 23.600, requires swap dealers to establish a risk management program to monitor and manage risks associated with their swap activities.

[4] Statement of Commissioner Dawn D. Stump Regarding Final Rule: Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants (July 23, 2020), available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement072320*.

[5] CFTC Letter No. 17-12, Commission Regulations 23.152(b)(3) and 23.153(c): No-Action Position for Minimum Transfer Amount with respect to Separately Managed Accounts (February 13, 2017), available at *https://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-12.pdf*.

learned. With the benefit of this time and experience, the Commission should then consider whether codifying such Staff action into rules is appropriate.[6]

As I have said before, "[i]t is simply good government to re-visit our rules and assess whether certain rules need to be updated, evaluate whether rules are achieving their objectives, and identify rules that are falling short and should be withdrawn or improved."[7] Experience with the Staff no-action relief in Letter No. 17-12 supports our rule change to tailor the application of the MTA under the Commission's uncleared margin rules in the SMA context.

Separate MTAs for IM and VM: The second rule change regarding the MTA that we are adopting similarly would codify existing Staff no-action relief in recognition of market realities. Consistent with Staff no-action Letter No. 19-25,[8] it would recognize that a swap dealer may apply separate MTAs for IM and VM with each counterparty, provided that the MTAs corresponding to IM and VM are specified in the margin documentation required under the Commission's regulations, and that the MTAs, on a combined basis, do not exceed the prescribed MTA.

Staff's no-action relief, and the Commission's rule amendments to codify that relief, take into account the separate settlement workflows that swap counterparties maintain to reflect, from an operational perspective, the different regulatory treatment of

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[6] *See* comments of Commissioner Dawn D. Stump during Open Commission Meeting on January 30, 2020, at 183 (noting that after several years of no-action relief regarding trading on swap execution facilities ("SEFs"), "we have the benefit of time and experience and it is time to think about codifying some of that relief. . . . [T]he SEFs, the market participants, and the Commission have benefited from this time and we have an obligation to provide more legal certainty through codifying these provisions into rules."), available at *https://www.cftc.gov/sites/default/files/2020/08/1597339661/openmeeting_013020_Transcript.pdf*.

[7] Statement of Commissioner Dawn D. Stump for CFTC Open Meeting on: 1) Final Rule on Position Limits and Position Accountability for Security Futures Products; and 2) Proposed Rule on Public Rulemaking Procedures (Part 13 Amendments) (September 16, 2019), available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement091619*.

[8] CFTC Letter No. 19-25, Commission Regulations 23.151, 23.152, and 23.153 – Staff Time-Limited No-Action Position Regarding Application of Minimum Transfer Amount under the Uncleared Margin Rules (December 6, 2019), available at *https://www.cftc.gov/csl/19-25/download*.

IM and VM.[9] And given that the total amount of combined IM and VM exchanged would not exceed the prescribed MTA, separate MTAs for IM and VM would not materially increase the amount of credit risk at a given time. Under Letter No. 19-25 and this codification, swap dealers and their counterparties can manage MTA in an operationally practicable way that aligns with the market standard.

There Remains Unfinished Business

While I am pleased with the steps the Commission is taking, there remains unfinished business in the implementation of uncleared margin requirements. The report of the GMAC Margin Subcommittee recommended several actions, beyond those that we are adopting, to address the hurdles associated with the application of uncleared margin requirements to end-users. Having been present for the development of the Dodd-Frank Act, I recall that the concerns expressed by many lawmakers at the time focused on the application of the new requirements to end-users. The unique challenges with respect to uncleared margin that caused uneasiness back in 2009-2010 are now much more immediate as the margin requirements are being phased in to apply to these end-users. As the calendar turns into the new year, I look forward to continuing to work together to address the other recommendations included in the GMAC Margin Subcommittee's report regarding applying the uncleared margin rules to financial end-users. The need to do so will only become more urgent as time marches on.

Conclusion

To be clear, these changes to the uncleared margin rules are not a "roll-back" of the margin requirements that apply today to the largest financial institutions in their swap transactions with one another. Rather, they reflect a thoughtful refinement of our rules to

[9] Under the Commission's uncleared margin rules, IM posted or collected by a swap dealer must be held by one or more custodians that are not affiliated with the swap dealer or the counterparty, whereas VM posted or collected by a swap dealer is not required to be segregated with an independent custodian. *See* 17 CFR 23.157.

take account of specific circumstances in which the rules impose substantial practical and operational challenges (*i.e.,* they are not workable) when applied to financial end-users that are now coming within the scope of their mandates.

I am very appreciative of the many people whose efforts have contributed to bringing this rulemaking to fruition. First, the members of the GMAC, and especially the GMAC Margin Subcommittee, who devoted a tremendous amount of time to provide us with a high-quality report on complex margin issues during the turmoil at the start of the pandemic. Second, Chairman Tarbert and my fellow Commissioners for working with me on these important issues. And finally, the Staff of the Market Participants Division, whose tireless efforts have enabled us to advance these initiatives to assure that our uncleared margin rules are workable for all, thereby enhancing compliance consistent with our oversight responsibilities under the CEA.

Appendix 3—Statement of Commissioner Dan M. Berkovitz

I. Introduction

I support today's two final rules that make tailored amendments to the CFTC's Margin Rule.[1] The Margin Rule requires swap dealers ("SDs") and major swap participants ("MSPs") for which there is no prudential regulator to post and collect, each business day, initial and variation margin for uncleared swap transactions with each counterparty that is an SD, MSP, or a financial end user with material swaps exposure ("MSE").[2] The Margin Rule is a lynchpin of the Dodd-Frank reforms for swaps markets, and critical to mitigating risks in the financial system that might otherwise arise from uncleared swaps.[3] I support the final rules because they provide targeted, operational

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[1] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016) ("Margin Rule").
[2] Although addressed in the final rules, there are currently no registered MSPs.
[3] Section 4s(e) of the Commodity Exchange Act ("CEA"), as amended by the Dodd-Frank Act, requires the Commission to adopt rules for minimum initial and variation margin for uncleared swaps entered into by SDs and MSPs for which there is no prudential regulator.

improvements to the Margin Rule; include backstops to deter any potential abuse; and are unlikely to increase risk to the U.S. financial system.

The two final rules address: (1) the definition of MSE and an alternative method for calculating initial margin ("MSE and Initial Margin Final Rule"); and (2) the application of the minimum transfer amount ("MTA") for initial and variation margin ("MTA Final Rule"). The final rules align Commission requirements with international frameworks developed by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions ("BCBS/IOSCO"),[4] and incorporate recommendations made to the CFTC's Global Markets Advisory Committee.[5] The final rules also build off existing CFTC staff no-action letters that in some cases have been in place since 2017, and that have operated with no apparent detrimental effects.

II. MSE and Initial Margin Final Rule

The MSE and Initial Margin Final Rule amends the definition of MSE to align it with the BCBS/IOSCO framework, including the method for calculating the average daily aggregate notional amount ("AANA") of swaps. The final rule provides for calculations based on the average of the last business day in each month of a three-month period. The Commission previously raised concerns that this method of AANA calculation could potentially become less representative of an entity's true AANA and swaps exposure, potentially through the use of "window dressing" to artificially reduce AANA during the measurement period.[6]

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[4] BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives (July 2019), available at *https://www.bis.org/bcbs/publ/d475.pdf*. The BCBS/IOSCO framework was originally promulgated in 2013 and later revised in 2015.

[5] Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps, Report to the CFTC's Global Markets Advisory Committee by the Subcommittee on Margin Requirements for Non-Cleared Swaps (Apr. 2020), available at *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download*.

[6] *See* Margin Rule, 81 FR at 645.

The MSE and Initial Margin Final Rule includes an important new provision to address this issue. The final rule explicitly prohibits any "[a]ctivities not carried out in the regular course of business and willfully designed to circumvent calculation at month-end to evade meeting the definition of material swaps exposure . . . ."[7] The addition of this language to the final rule's regulatory text will help ensure that CFTC efforts at international harmonization will not come at the expense of the safety and soundness of the U.S. financial system.[8] I thank the Chairman and the CFTC staff for working with my office to include this provision.

The MSE and Initial Margin Final Rule will also allow SDs and MSPs for which there is no prudential regulator ("Covered Swap Entities" or "CSEs") to rely on the initial margin calculations of the more sophisticated counterparties with whom they transact swaps to manage their risks. This flexibility is limited to circumstances where a CSE enters into uncleared swaps with an SD, MSP, or swap entity to hedge its customer-facing swaps. This amendment to the Commission's existing rules could help promote liquidity and competition in swaps markets by increasing choice for end-users that are CSE customers.

The MSE and Initial Margin Final Rule provides helpful direction regarding the scope of hedging swaps for purposes of relying on a CSE counterparty's initial margin calculations. As set forth in the preamble to the final rule, a hedging swap must be consistent (although not identical) with the statutory definition of "bona fide hedging transaction or position" in CEA section 4a(c)(2)(B).[9] The final rule also makes clear that existing Commission regulations require a CSE that relies on its counterparty's initial

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[7] MSE and Initial Margin Final Rule at new § 23.151 (defining "Material Swaps Exposure").

[8] The preamble to the MSE and Initial Margin Final Rule also notes an analysis by the CFTC's Office of the Chief Economist indicating that the new month-end AANA calculation method captures substantially the same entities and total number of entities as the Commission's previous daily AANA calculation method. As with any rulemaking, the Commission is free in the future to periodically review its data and confirm that the new AANA calculation method is performing as expected.

[9] 7 U.S.C. 6a(c)(2).

margin calculations to also take steps to "monitor, identify, and address potential shortfalls in the amounts of [initial margin] generated by the counterparty on whose [initial margin] model the CSE is relying."[10]

III. MTA Final Rule

To reduce operational burdens associated with de minimis margin transfers, the Margin Rule provides that a CSE is not required to collect or post margin until the combined amount of initial margin and variation margin that is required to be collected or posted and that has not been collected or posted with respect to the counterparty exceeds $500,000—the MTA.[11] This MTA level, in part, helps limit the amount of a counterparty's uncollateralized, uncleared swaps exposure and mitigate any systemic risk arising from such swaps.

The MTA Final Rule addresses the application of the $500,000 MTA level to a counterparty's "separately managed accounts," as well as the use of separate MTAs for initial and variation margin.[12] The MTA Final Rule codifies separate treatment for separately managed accounts and permits an MTA of $50,000 for each such account of a counterparty. This approach responds to practical limits on the ability of asset managers, for example, to aggregate initial and variation margin obligations across multiple separately managed accounts owned by the same counterparty. The MTA Final Rule also provides that if certain entities agree to separate MTAs for initial margin and variation margin, the respective amounts of MTA must be reflected in their required margin documentation.

These new provisions balance concerns over operational inefficiencies and practical challenges in the Commission's MTA rules against concerns that they may

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[10] MSE and Initial Margin Final Rule at section II(B).
[11] 17 CFR 23.151
[12] Both aspects of the MTA Final Rule were the subject of CFTC staff no-action letters issued in 2017 and 2019, respectively.

result in the exchange of less total margin than would be the case under the Commission's current requirements. Comments in response to the proposed rule noted the difficulties that would be associated with creating numerous separately managed accounts solely to evade the comparatively low $50,000 MTA for separately managed accounts. The MTA Final Rule also defines separately managed account so that the swaps of such account are not subject to a netting of initial or variation margin obligations. This potentially provides further disincentive to create separately managed accounts solely for the purpose of evading the $50,000 MTA level for such accounts.

IV. Conclusion

Mitigating systemic risk to the U.S. financial system was a primary objective of the Dodd-Frank Act in 2010, and of subsequent Commission rulemakings to implement Dodd-Frank, including the Margin Rule adopted in 2016. The Commission must remain committed to the Margin Rule and vigilant for any large pool of uncollateralized, uncleared swaps exposure. Today's targeted final rules, which codify existing practices, include embedded backstops, and provide tailored operational enhancements to the Margin Rule, are unlikely to present systemic risks.

I thank staff of the Market Participants Division for their work on these final rules.

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